

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

REYMUNDO COSME : DETERMINATION
D/B/A FORDHAM ROAD MEAT FOOD CENTER : DTA NO. 819575

for Revision of a Determination or for Refund of Sales and :
Use Taxes under Articles 28 and 29 of the Tax Law for the
Period September 1, 1998 through November 30, 2001. :

Petitioner, Reymundo Cosme, d/b/a Fordham Road Meat Food Center, 178 West Fordham Road, Bronx, New York 10468-5660, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1998 through November 30, 2001.

A hearing was held before Gary R. Palmer, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on April 30, 2004 at 12:00 P.M., with all briefs to be submitted by August 20, 2004, which date began the six-month period for the issuance of this determination. Petitioner appeared by Manuel Vidal, Public Accountant. The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Cynthia E. McDonough, Esq., and Michael P. McKinley, Esq., of counsel).

ISSUE

Whether the indirect audit method employed by the Division of Taxation was reasonably calculated to determine sales tax due.

FINDINGS OF FACT

1. Pursuant to section 3000.15(d)(6) of the Rules of Practice and Procedure of the Tax Appeals Tribunal and section 307(1) of the State Administrative Procedure Act, the Division of Taxation (“Division”) submitted proposed findings of fact, which have been substantially incorporated into this determination.

2. Petitioner operates a large neighborhood grocery store in a mixed residential and commercial area of the Bronx. The store has about 2,016 square feet of floor space with six grocery aisles and one aisle with cleaning products. It is open seven days a week. Petitioner has owned and operated the store as a sole proprietorship since he opened it in 1998.

3. On September 20, 2001 a Division investigator conducted a field visit to the store and was informed by the store manager that it had average gross sales of about \$1,350.00 per day. Upon his review of petitioner’s sales tax reporting history, the investigator concluded that petitioner was reporting significantly less than \$1,350.00 per day in sales and was, therefore, underreporting his gross and taxable sales.

4. On November 2, 2001, the Division’s auditor, mailed an audit appointment letter to petitioner, advising that a sales and use tax audit would commence on November 14, 2001 at petitioner’s office and requesting that all books and records pertaining to the store’s sales and use tax liability for the audit period should be made available on the appointment date. The stated audit period was from June 1, 1998 through August 31, 2001. The letter referenced an attached records requested list which set forth the records to be produced as follows:

sales tax returns, worksheets, canceled checks, NYS corporation tax returns, general ledger, general journal and closing entries, sales invoices, exemption documents supporting non-taxable sales, chart of accounts, fixed asset purchase/sales invoices, bank statements and deposit slips, cash receipts journal and sales journal, cash disbursement journal, purchase journal, federal tax returns and the corporate book.

5. On November 14, 2001, the auditor went to the business location, but petitioner was not available. The auditor left his business card with a store employee and requested that petitioner contact him by telephone. When he did not hear from petitioner, the auditor returned to the store on December 5, 2001 and again left his business card. A store employee provided the auditor with two telephone numbers where petitioner might be reached. The record does not indicate what use the auditor made of these telephone numbers. On January 24, 2002 the auditor visited the store for the third time and left his business card. Later that same day Mr. Vidal contacted the auditor by telephone and scheduled an appointment for February 4, 2002.

6. On February 4, 2002, the auditor met with Mr. Vidal at the latter's office. Because Mr. Vidal had no books and records for review, the auditor provided him with a copy of the records requested list. A power of attorney appointing Mr. Vidal as petitioner's representative for the period from June 1, 1998 through November 30, 2001 was filed with the Division on March 5, 2002. On March 6, 2002, the auditor contacted Mr. Vidal by telephone to determine if the requested books and records were available for review. Mr. Vidal advised that he was still trying to obtain some invoices. On the same date the auditor sent an appointment letter to Mr. Vidal extending the audit period to include the sales tax quarter ending November 30, 2001 and specifically requesting all books and records pertaining to petitioner's sales and use tax liability for the updated period. The letter scheduled an appointment for a field audit at petitioner's office on March 26, 2002 at 9:30 A.M. and included a records requested list that was identical to

the records requested list dated November 2, 2001, except for the addition of depreciation schedules to the earlier listing. Also on March 6, 2002, the auditor and his supervisor began making plans for a one-day observation test of petitioner's taxable and nontaxable sales.

7. The record includes two consents extending the period of limitations for assessment of sales and use taxes. The first such consent was signed by petitioner on February 16, 2002 and by the Division on March 8, 2002. It evinces the agreement of the parties that the amount of sales tax due for the period from December 1, 1998 through May 31, 1999 might be determined at any time on or before June 20, 2002. The second consent was signed by petitioner and the Division on June 20, 2002 and states the agreement of the parties that the amount of sales tax due for the period from June 1, 1998 through November 30, 1999 might be determined at any time on or before December 20, 2002.

8. Although the record is silent as to what took place at petitioner's office on March 26, 2002, the Division, having received no records of petitioner's sales, did resort to a one-day observation test of petitioner's sales on Tuesday, May 28, 2002. A Tuesday was chosen for the observation test because, based on audit experience, Tuesdays are usually slow days compared to other days of the week. The observation test was conducted by two Division investigators, Mr. Barr, who recorded petitioner's taxable sales between the hours of 7:15 A.M. and 3:30 P.M., and Mr. Cruz, who then took over and recorded taxable sales until closing. The investigators recorded petitioner's sales on a printed tally sheet which contained two printed columns listing taxable food, beverage, tobacco products and other taxable items. They entered a tick mark next to each item sold at a given price. For example, for tobacco products the sheet had five separate lines marked CIG/CGR/TBCO. The investigator entered different tobacco product prices on

different lines and circled CIG for cigarette sales or CGR for cigar sales. Then each separate cigar or cigarette sale at a given price would be recorded by a tick mark next to the price to indicate, for example, the number of cigarette sales at \$5.75, the number of cigarette sales at \$5.15, and the number of cigar sales at \$.50, etc. Petitioner testified that the store closed at 9:00 P.M. on May 28, 2002, while Mr. Cruz recorded the closing time on the tally sheet as 10:00 P.M.

9. The Division determined petitioner's total taxable sales for the May 28 observation day to be \$1,201.26 and petitioner's gross sales for that day to be \$1,860.00. Gross sales were determined to be the total amount of cash in the cash register at the end of the day. Petitioner's ratio of taxable sales to gross sales for May 28, 2002 was 65 percent. Total cigarette sales, which here includes all tobacco products, for the day were \$318.45. To determine total taxable sales for the audit period, the auditor first subtracted the cigarette sales from the total taxable sales for the day (\$1,201.26 - \$318.45) resulting in taxable grocery sales for the day of the observation in the sum of \$882.81. Using 1,218 days as the total days in the audit period, the auditor multiplied the total taxable grocery sales of \$882.81 by the 1,218 total days to arrive at total taxable grocery sales for the audit period of \$1,075,262.58, which, when multiplied by the .0825 sales tax rate, yielded sales tax due on the taxable grocery sales for the audit period of \$88,709.16. For the cigarette sales, which included sales tax, the auditor multiplied the \$318.45 in sales for the observation day by 1,218 days yielding total cigarette sales for the audit period of \$387,872.10. Next the auditor determined total cigarette sales net of sales tax in the sum of \$358,311.41, which when multiplied by the sales tax rate of .0825 yielded total sales tax due on cigarette sales for the audit period of \$29,560.69, and total sales tax due for the audit period of

\$118,269.85. From this figure sales tax paid by petitioner for the audit period in the sum of \$20,747.00 was subtracted by the auditor, leaving additional sales tax due of \$97,522.85.

10. Asset acquisition records were found to be adequate and subjected to audit. No additional tax was determined to be due on fixed assets.

11. On October 28, 2002, the Division issued to petitioner a notice of determination imposing tax, statutory interest and penalties in the total sum of \$171,299.23. The penalties consisted of the negligence penalty pursuant to Tax Law § 1145(a)(1)(i) for all sales tax quarters at issue, and the omnibus penalty pursuant to Tax Law § 1145(a)(1)(vi) for all sales tax quarters except the last quarter at issue, that ending November 30, 2001.

12. Petitioner filed a request for a conciliation conference with the Bureau of Conciliation and Mediation Services on or about November 12, 2002. Neither petitioner nor his representative appeared for the conciliation conference scheduled for March 20, 2003. As a result the Conciliation Conferee issued a conciliation default order on April 25, 2003. Petitioner filed a petition for a hearing with the Division of Tax Appeals on or about July 24, 2003.

SUMMARY OF THE PARTIES' POSITIONS

13. Petitioner concedes that he failed to produce adequate records sufficient to permit a detailed audit of his sales tax liability, but asserts that a one-day observation test of his sales activity is not reasonably calculated to determine the level of petitioner's gross and taxable sales over a multiyear period. He also maintains that the percentage of his gross sales that are subject to sales tax does not exceed 45 percent.

14. The Division argues that petitioner failed to maintain and produce source records of his sales for the period at issue, and as a consequence, the use of an indirect audit method in the form of a one-day observation of petitioner's taxable sales was appropriate.

CONCLUSIONS OF LAW

A. When, as here, the Division resorts to an indirect audit method, it must establish that the taxpayer's books and records were so deficient as to render it virtually impossible to determine the taxpayer's liability solely from those books and records (*Matter of Urban Liquors, Inc. v. State Tax Commission*, 90 AD2d 576, 456 NYS2d 138). In order to establish that the taxpayer's books and records are inadequate, the Division must first request (*Matter of Christ Cella v. State Tax Commission*, 102 AD2d 352, 477 NYS2d 858) and then thoroughly examine the books and records for the entire audit period (*Matter of King Crab Restaurant v. Chu*, 134 AD2d 51, 522 NYS2d 978). The record clearly supports the Division's two clear and unequivocal written requests, as well as a verbal request, for books and records bearing on petitioner's sales and his failure to keep or produce such records for the Division's review. The auditor reasonably concluded that petitioner did not maintain books and records that were sufficient to verify his gross and taxable sales for the audit period. Having established the insufficiency of petitioner's books and records, the Division properly resorted to external indices in the form of a one-day observation test of petitioner's gross and taxable sales.

B. Petitioner opines that because the level of sales at his store varied by day of the week and was impacted by changes in weather conditions, the use of a one-day observation test to determine total sales over the course of a year is unreasonable. The extrapolation of the results of a one-day observation test over a multiyear period has repeatedly been found to be reasonable

(*see, Matter of Del's Mini Deli, Inc. v. Commissioner of Taxation and Finance*, 205 AD2d 989, 613 NYS2d 967; *Matter of Sarantopoulos v. Tax Appeals Tribunal*, 186 AD2d 878, 589 NYS2d 102; *Matter of Marte*, Tax Appeals Tribunal, August 5, 2004).

C. The copy of the May 28, 2002 tally sheet in the Division's audit file includes a notation reading "Out @ 10 PM." Petitioner, in an effort to raise doubt regarding the integrity of the observation test, placed in evidence a copy of the tally sheet that was in all respects identical to the audit file tally sheet except for the absence of the "Out @ 10 PM" language and the audit file page number. Whether the store closed at 10 P.M. or at 9 P.M. on May 28, 2002, as asserted by petitioner, is not material to the issue of whether the taxable sales listed for that day by the Division's investigators are accurate. Presumably, if the store closed at 9 P.M. instead of 10 P.M., there would be fewer taxable sales for the day which would inure to the benefit of petitioner. Mr. Cosme, when asked if the taxable sales on the tally sheet were accurate, responded that he never knew what was taxable and never charged tax for (bottled) water (*see*, 20 NYCRR 528.3[b]). I find that petitioner has failed to impeach the integrity of the Division's observation test.

D. It is petitioner's burden to show that the audit method employed by the Division or the amount of tax assessed is erroneous (*Matter of Surface Line Operator's Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451). Petitioner has done neither. Petitioner takes issue with the Division's audit method because it is imprecise. However, any imprecision in the audit method employed arises by reason of petitioner's own failure to keep and maintain records of all his sales as required by Tax Law § 1135(a)(1) (*Matter of Markowitz v. State Tax Commission*, 54 AD2d 1023, 388 NYS2d 176, *affd* 44 NY2d 684, 405 NYS2d 454). It is noted that the

Division, in its computation of total taxable sales for the audit period, first multiplied total taxable grocery sales for the observation day and then total tobacco product sales for the observation day by 1,218 days. However, the audit period, from September 1, 1998 to November 30, 2001, consists of only 1,187 days.

E. The petition of Reymundo Cosme d/b/a Fordham Road Meat Food Center is granted to the extent indicated in Conclusion of Law “D” and the notice of determination shall be modified so that the tax computation is based on the correct number of days in the audit period. In all other respects the petition is denied and the notice of determination dated October 28, 2002, as modified, is sustained.

DATED: Troy, New York
November 4, 2004

/s/ Gary R. Palmer
ADMINISTRATIVE LAW JUDGE